



December 31, 2009

VIA EMAIL: eaac@calepa.ca.gov
Economic and Allocation Advisory Committee (EAAC)
California Environmental Protection Agency
1001 "T" St
Sacramento, CA 95812 EAAC

Subject: Suggestions for EAAC's Draft Recommendations for Allowance Allocation and Uses of Allowance Value

Dear EAAC Members,

Thank you for your work in establishing a factual basis for recommendations, and for your determined efforts to provide opportunities for public review and comment. This brief letter suggests additions and modifications to EAAC recommendations with the aim of bettering the AB32 cap and trade program. While EDF generally agrees with the recommendations drafted by EAAC, our suggestions are:

- **Return allowance value as energy services and efficiency investment loans:** Make energy services and efficiency investments the default way to return allowance value to the people of California, with cash payments an opt-in option.
- **Estimate total allowance value conservatively:** Calculate the potential total allowance value considering a lower market clearing price for compliance instruments. The draft EAAC report considers a range from \$20 to \$65 per ton CO₂e, but \$5 per ton is a more appropriate low end of the range.
- **Open carbon markets:** Allow local governments and community organizations to earn the market value of emissions reductions that they achieve within capped sectors.
- **Inspire investments in disadvantaged communities:** Envision a crediting mechanism that encourages emissions reductions within disadvantaged communities.

Environmental Defense Fund supports the recommendations drafted thus far by EAAC. This support refers to EAAC draft recommendations dated December 14th, 2009. In particular, Environmental Defense Fund concurs with the recommendation of using auctions as the primary means to distribute allowances, and we applaud EAAC's recognition of the important roles to be played by public (e.g., local government) and private (e.g., community organizations) parties.

Allocate allowances via auctions. Environmental Defense Fund is pleased that EAAC recommends auctioning as the preferred means for distributing allowances. Compared to free administrative allocation, Environmental Defense Fund agrees with EAAC that relatively small issues of leakage can be addressed through using of auction proceeds. However, we are concerned that some laudable objectives may be best pursued using allowance allocations rather than disbursements of allowance value. For example, setting aside allowances – removing them from the pool of allowances to be sold at auction – is justified in several cases, notably to provide credit for a priori reductions by regulated entities, voluntary renewable electricity generation, and local government and community actions that achieve GHG reductions. We discuss this latter opportunity, below, in the context of opening carbon markets to third-parties that can deliver GHG reductions and co-benefits in disadvantaged communities simultaneously. EAAC can help to deflate the contentious issue of allowance set asides by recommending worthy actions specifically.

Environmental Defense Fund agrees that border adjustments are a viable and potentially attractive mechanism to aid firms transitioning to low-carbon production methods. EDF also agrees that any policy to mitigate leakage ought to be "substantially modified or cancelled" quickly (though not whimsically), in the event of policy actions that substantively mitigate leakage, such as a national cap and trade program. Such modification or cancellation can be planned thoughtfully to provide as much regulatory certainty as feasible while national and international policies remain undefined.

Estimate the size of the allowance market using a lower market clearing price for allowances, such as \$5 per ton. On page 29, Table 2 presents estimates total allowance value as a function of allowance prices. This useful contribution would be improved with broader thinking. EDF applauds using a range in this context, but questions why the low end is a \$20 per ton CO₂e. Given evidence suggesting an ample supply and depressed demand for allowances, a much lower market clearing price should be contemplated, such as \$5 per ton CO₂e.

The AB32 Scoping Plan supporting analyses forecasted allowance prices in the range of \$10 per ton in 2020. Also, there is a low likelihood of real scarcity in the early phases of the program. Several design decisions in favor of cost containment, such as banking, offsets, early actions credit and early phase allowance budgets on par with emissions indicate ample supply.

Demand is reduced already; targets are less ambitious in light of the recent slow-down in economic production. These design "pressures" follow trends from prior compliance programs (e.g., US Acid Rain, RGGI, EU-ETS). It is quite reasonable to expect allowance prices will be at or below \$10 per ton CO₂e for the foreseeable future.

Return allowance value to the people of California in ways that further the goals of AB32 by providing efficiency services and loans for efficiency investments. Clearly and rightly, EAAC is demonstrating serious attention to the matter of protecting and benefiting our most disadvantaged communities. EAAC recommends

"...sufficient allowance value be conferred to low-income households to avoid disproportionate adverse economic impact of AB 32 on such households. Such conferral

should be accomplished through financial transfers rather than through subsidized energy prices." Recommendation 7, Dec. 14 draft, page 59.

And,

"...devote a significant share of allowance value toward financing of public and private investment oriented toward achieving low-cost emissions reductions, adaptation, and environmental remediation" Recommendation 9, Dec. 14 draft, page 59.

Environmental Defense Fund concurs while recommending that EAAC provide a definition of sufficiency in this context and that EAAC be more creative and constructive in recommending ways to deliver the value of allowances to the people of California. Simple "financial transfers" provide little link to efficiency investments necessary to achieve AB32 goals of maximizing reductions at minimal cost. Allowance value "dividends" ought to be delivered as energy efficiency services, such as energy audits, and as financing for investments, such as weatherization and replacement of inefficient appliances. While the alternatives preferred by EAAC, cash disbursements or reduced productivity taxes, are simple and transparent, they provide little in the fight against global warming. Quite the opposite, financial transfers can create additional demand for carbon-intensive goods and services.

Environmental Defense Fund envisions allowance value "dividends" as an opportunity to deliver services that reduce or avoid emissions in homes and small businesses, and as an initial funding source for an efficiency investment fund that provides low and zero-interest loans for investments by low-income residents and small businesses. In our September comment letter to EAAC, Environmental Defense Fund wrote,

Despite our collective wisdom, we still routinely provide rate discounts to low-income ratepayers... A more effective means of assisting low-income electricity rate payers would be providing rebates or directly investing in building and appliance efficiency.

EAAC has rightly avoided recommending the use of existing utility rate payer subsidy programs. Unlike cash disbursement that risk legal nexus challenges, energy services and efficiency investments will deliver tangible GHG benefits and provide environmental benefits and economic protections for energy users.

Appendix A is a report, Left to Our Own Devices, that I co-authored with Steven Moss, Executive Director of SF Community Power. The report examines the sufficiency of micro-financing for efficiency investments. The core finding of the paper, as summarized in the table below, is that the many existing funding sources are inadequate for low-income households and small businesses. In Chapter IV of the report, we explore two particularly intriguing new funding approaches: (a) pooling of reductions for carbon market crediting and (b) using utility bill subsidies for efficiency investments. We show that utility rate subsidies (CARE program subsidies in our study) can yield better economic and environmental results if provided as efficiency investments, such as appliance replacements.

How Available and Potential Financing Options Address Access Barriers

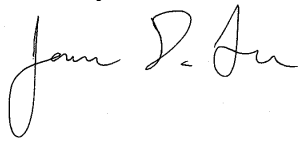
Mechanism	Description	Financier	Experience	Limitations for low-income households and small businesses
Utility financing	Rate payer funded subsidies	Ratepayers/Utility	Extensive	Insufficient penetration rates even after decades of experience
Traditional Loans	Loan repayments on regular schedule	Banks, Retail stores	Extensive	Split incentives; Lenders dissuaded from small loans or low-income customers by credit risk and transactions costs
On-bill financing	Loan repayment via utility bills	Utility or energy services company	Limited but expanding	Billing system incompatibilities, consumer skepticism, needs associated education services
Energy Financing District	Loan repayment via property tax assessment	Local government	Limited but expanding	High transactions costs so not used for smaller interventions
Energy Efficiency Local Improvement District	Loan repayment associated with property, not tenant	Local government	Very limited	Requires majority approval by owners within district
Public loan fund based on municipal bonds	Traditional loan repayment with better terms	Local government or private entity	Very limited	Similar access and transactions costs issues as traditional loans
Energy Efficiency Mortgages	Traditional loan repayment	Banks; mortgage brokers	Very limited	Only at time of sale; difficult in tough housing market; difficult administration & verification
Micro-loans	Low-interest loans to small businesses with limited access to credit to expand commercial operations	Development banks, federal or state government funds distributed by local lenders	Extensive in other countries	Not used typically to reduce operating costs
Third-Party Investments	Private service providers earn a share of avoided energy bills	Energy Services or Management Companies	Limited to larger commercial interests	Transaction costs must be overcome for small commercial and residential customers; consumer demand must grow to attract investors.
Leases and Power Purchase Agreements	Investments repaid via power contracts or leases	Utilities, On-site power companies	Extensive for large investments	Faces similar challenges as third-party investments for smaller energy users
Bill subsidy monetization	Rather than power rate discounts, use value for capital investments	Utilities	Limited	Requires education for customer to recognize beneficial tradeoff
Carbon market crediting	Aggregating emissions reductions for carbon market crediting	Community benefits organizations or local governments	Very limited, but examples from voluntary and regulatory GHG offsets programs & "white tag" efficiency programs	Transactions costs high for individual monitoring and verification
Carbon policy revenue returns	Climate policy revenues used for micro-financing	Regulators in association with utilities or banks	Limited, but similar example in Alaska's Permanent Fund	Revenues would likely be disbursed via traditional lending programs

Open carbon markets to non-regulated third parties to inspire efficiency investments that yield both GHG reductions and co-benefits in disadvantaged communities. Environmental Defense Fund supports the creation of a Community Benefits Fund (CBF) that contains a "fixed fraction of total allowance value devoted to investment...to support climate change mitigation and adaptation in disadvantaged communities" (Recommendation 15, Dec. 14 draft, page 62). EAAC could make an additional contribution by estimating the needed magnitude of the fund, and by suggesting how the fund might be directed toward investments in disadvantaged communities that also achieve GHG reductions. A related EAAC recommendation for a community impact compensation fund (Recommendation 14, Dec. 14 draft, page 61) is well intended, yet EDF hopes that adverse impacts can be avoided entirely by careful program design. Environmental Defense Fund believes another mechanism can be put into place to complement the community benefit and compensation funds that inspires investments in disadvantaged communities by awarding the market value of allowances to third parties that can demonstrate real and additional GHG reductions within capped sectors.

EDF has commented extensively on this concept of pooling reductions achieved by community-scale actions at CARB workshops (such as the May 18, 2009 workshop on setting aside allowances) and in our September letter to EAAC. EDF remains enthusiastic about the potential to create a "race to efficiency" in our most disadvantaged and underinvested communities and we are pleased that the EAAC draft report recommends "financing of public and private investment oriented toward achieving low-cost emissions reductions". However, EAAC can more proactively suggest that community-based emissions reduction pooling can be an integral feature of the cap and trade program.

We can achieve the goals of AB32 in a manner that supports California's broad economic, environmental and social justice goals. This includes securing environmental performance with an airtight emissions cap, transition assistance for trade-exposed, energy intensive commercial interests and labor, and support for consumers, particularly small businesses and residents in our most disadvantaged communities. Concurrently, California's cap and trade program must be developed to link with national and international programs. The EAAC draft recommendations largely support these goals, yet could be more visionary in recommending a cap and trade program that is deeply beneficial for all members of California's diverse society.

Sincerely,



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Attachment A via separate email):

Fine, J. and Moss, S. (December 2009) Left To Our Own Devices: Financing Efficiency For Small Businesses & Low-Income Families. Environmental Defense Fund.